

Russia Economic Review

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Despite failed talks in Doha, the relative stability of oil prices and the rouble has been maintained. Domestic demand remains weak, but real wage growth in February provides cause for optimism.

- After talks on freezing oil production failed on 17 February, the price of Brent crude oil fell to \$40pbl, but soon rebounded to pre-negotiation levels – not least because of a three-day oil workers' strike in Kuwait – and remained more or less stable hinting that the oil market may have bottomed out.
- Industrial production's rate of decline eased to -0.5%Y/Y in March. Some sectors showed double-digit growth and are increasing their market share thanks to the weaker rouble and import ban on certain goods.
- While March's retail sales decreased by 5.8%Y/Y, February's reading was revised upward to -4.3%Y/Y. Car sales were down by 10%Y/Y in March and the market does not yet appear to have found a firm bottom. But some luxury brands such as Cadillac and Alfa-Romeo have bucked the trend and enjoyed triple-digit sales growth.
- February's real wage growth was revised up to 0.6%Y/Y and with a relatively low unemployment rate (6% in March) may suggest that domestic demand will start to strengthen in coming months.

Market remains relatively calm despite failed Doha talks on freezing oil production

After the talks in Doha on freezing oil production failed, oil prices inevitably corrected downward to about \$40pbl, but this move proved to be short lived and prices bounced back to \$42pbl (the pre-negotiations level) later on Monday 18 April – the day following the unsuccessful talks. And while the three-day Kuwaiti oil workers' strike, which saw the oil output of the country fall by 40% during the period, supported the fast rebound of oil prices, the fact that the oil market remains stable after the strike's end, and the slow upward trend continues, suggests that the oil market might have reached its bottom and might be about to start to revive. For the time being we expect markets to be affected by news on the Chinese economy, US oil output and inventories, but think that oil prices will gradually rebound to the levels where the balance between demand and supply is sustained, which is now believed to be around \$50pbl.

In January to February this year, Russia's oil production increased by 4.1%Y/Y. In February output increased by 7.4%Y/Y, but slowed by 4.7%M/M compared to the previous month. In physical terms, in February Russia was producing 10.03mn barrels/day, slightly behind Saudi Arabia with 10.14mn barrels/day and roughly one third of the total amount produced by OPEC of 32.28mn barrels/day. Almost half (47.6%) of Russian oil was exported. Oil accounted for 23.5% of total Russian exports (February).

And as oil prices appear to start to rebound, although slowly, so does the Russian economy. Indeed, the Russian government announced that it will return to three-year budget planning instead of the single-year budget approach adopted in 2015 amid a volatile global environment in which arguably medium-term planning was difficult. We see this step as a positive one towards budget balancing under the external restrictions of relatively low oil prices and sanctions, especially at a time when Russia is about to start an electoral cycle with parliamentary elections in September this year and a presidential election in 2018, which inevitably will bring more governmental expenses.

Industrial production decreased by 0.5%Y/Y – less than half the Bloomberg consensus forecast

Industrial production in March was down by 0.5%Y/Y and while this might look like a setback after 1.0%Y/Y growth in February, the decline was still half of the Bloomberg consensus (1.0%Y/Y). On the other hand, monthly production in March increased by 9.1%M/M (seasonally adjusted 0.4%M/M) compared to the previous month. In the first three months of 2016, industrial production was down by 0.6%Y/Y.

In the details, in Q116 mining sector output grew by 3.4%Y/Y (-4.0%Q/Q) and production of electricity, water and gas was also positive at 0.6%Y/Y (7.6%Q/Q), while manufacturing production was still struggling to get back to the path of recovery and decreased by 3.1%Y/Y (-19.7%Q/Q). And while production of light vehicles in March was indeed disappointing, down by 25.9%Y/Y (-1.8% M/M) not least because of high inflation and weak domestic demand, some sub-categories of consumer goods and food show double-digit growth. In fact, production of meat was up 13.2%Y/Y (8.9%M/M), buckwheat 13.4%Y/Y (0.7%M/M), fabrics 25.6%Y/Y (13.4% M/M), medical equipment 16.9%Y/Y (24.7 M/M), and refrigerators 21.6%Y/Y (27.4%M/M), showing that some domestic brands are indeed successfully expanding market share in the favourable environment of a weakened rouble and an import ban on certain products related to sanctions.



Retail sales are still weak, but seem to move in the right direction

Preliminary figures for retail sales in March showed sales down by 5.8%Y/Y and while the reading fell below the Bloomberg consensus forecast of -5.1%Y/Y, it was a touch better than the preliminary estimate for February of -5.9%Y/Y. Considering the fact that February's retail sales dynamic was revised up to -4.3%Y/Y we see that there are signs that consumption may start to increase in coming months.

While car sales remain weak, the scale of decline has narrowed to 10%Y/Y in March – 3ppt less than the previous month and also better than the Bloomberg consensus forecast of the same rate, -13%Y/Y. In Q116, 320,000 cars were sold in Russia and nine of the top ten models were produced locally. And while some major brands, both domestic and foreign, suffered from decreasing sales in some cases up to -50%Y/Y, some luxury foreign brands like Cadillac and Alfa-Romeo, albeit with a tiny market share, have indeed managed to increase their sales at a triple-digit rate – Cadillac sold 140 cars in March, a 240% increase compared to a year ago – illustrating the popularity of luxury brands in Russia.

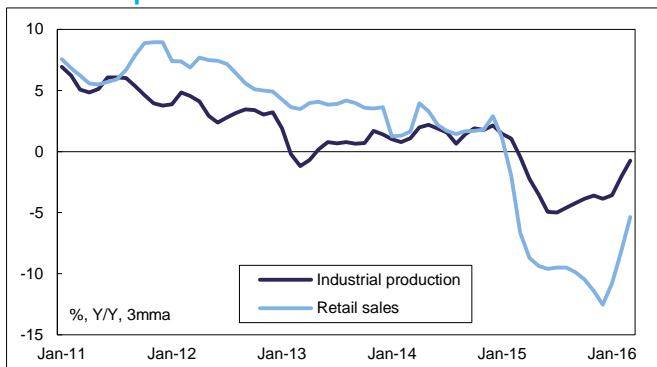
Meanwhile, while the consumer confidence index for Q116 was disappointing at -30%, down 4ppt compared to Q416, this suggested that consumer sentiment has slightly improved compared to the level a year ago of -32%. The survey also shows that while almost half of respondents admitted that the time is neither good for spending – sentiment regarding the purchase of durable goods was -43% (from -45% in 2015) – nor for savings (although consumers have adjusted their savings expectations upward from -52% a year ago, to -49%). At the same time economic sentiment related to the development of their personal financial situation in the next 12 months improved to -15%, compared to -19% a year ago, and was at the same level as in the previous quarter.

Real wages data gave some cause for optimism

At first sight, the growth of real wages in March was slightly disappointing as wages fell 3%Y/Y, 0.4ppt worse than the preliminary reading in February of -2.6%Y/Y. But the upward revision of the previous month's figure to positive growth of 0.6%Y/Y provides some cause for optimism. In nominal terms average monthly salary in March was of 35,570 roubles (around 55,000 JPY), up by 9.0%Y/Y.

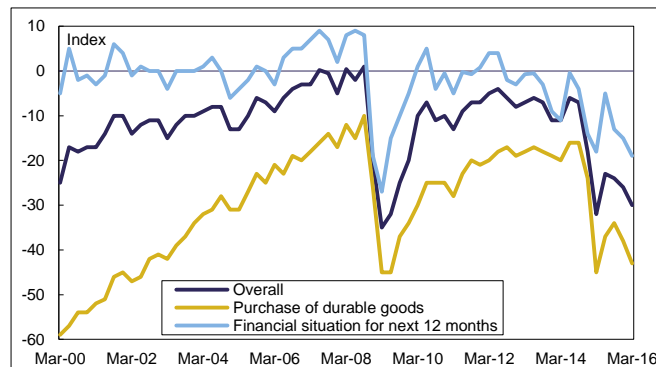
While the unemployment rate reached 6.0% in March, up by 0.2ppt compared to the previous month and also a touch worse compared to the Bloomberg consensus of 5.9% it is still within the government forecast for this year (up to 6%) and is relatively low by global standards considering the severe economic environment in Russia over past two years.

Industrial production and retail sales



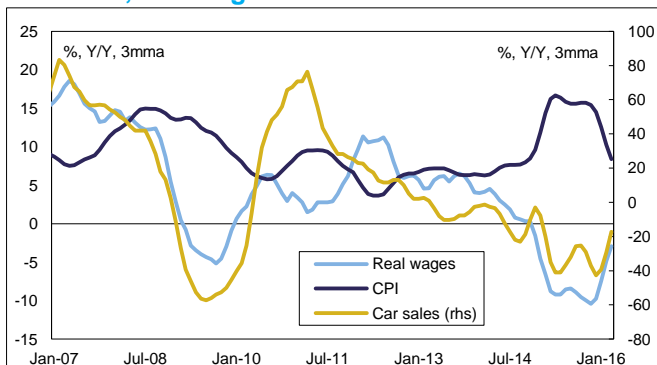
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Consumer confidence



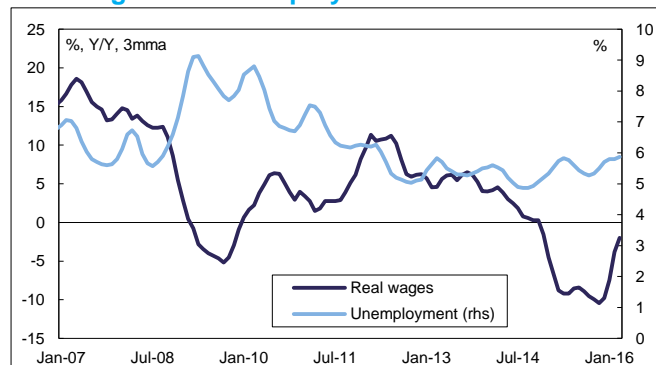
Bloomberg and Daiwa Capital Markets Europe Ltd.

Car sales, real wages and CPI



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Real wages and unemployment



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